Before the
FEDERAL COMMUNICATION COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992; Rate Regulation	)	MM Docket No. 93-215
	)	
and	)	
	)	
Adoption of a Uniform Accounting System for Provision of Regulated Cable Service	)	CS Docket No. 94-28

OPPOSITION OF CABLEVISION SYSTEMS CORPORATION TO PETITION FOR PARTIAL RECONSIDERATION OF SOUTHERN NEW ENGLAND TELEPHONE COMPANY

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Cablevision Systems Corporation, by its attorneys, hereby submits its Opposition to the Petition of the Southern New England Telephone Company ("SNET"), filed February 26, 1996, for Partial Reconsideration of the Commission's Second Report and Order (the "Petition").[1]

I. INTRODUCTION AND BACKGROUND

The Commission should reject SNET's Petition as outside of the scope of this proceeding and unjustified as a substantive matter. SNET's request that the Commission "harmonize" the cable and telephone cost allocation rules by "amending" the cable operator

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[1] In the Matter of Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992: Rate Regulation and Adoption of a Uniform Accounting System for Provision of Regulated Cable Service; Second Report and Order, First Order on Reconsideration, and Further Notice of Proposed Rulemaking, 11 FCC Rcd 2220, 2222 (rel. Jan. 26, 1996)("Second Report and Order").

affiliate transaction rule so that it applies to cable operators regulated under both the cost-of-service and benchmark ratesetting methodologies is misplaced in this proceeding. This proceeding and its record relate to the Commission's revision of the cost allocation rules applicable to cable operators seeking to establish or justify regulated rates in accordance with the Commission's cost-of-service ratesetting approach. The issue of regulatory parity between rate-regulated cable television systems and telephone local exchange carriers ("LECs"), while perhaps an interesting policy issue that could be examined in the future, is clearly outside of the scope of this proceeding, as delineated in the Notice[2] and in the Second Report and Order.

Contrary to what was suggested in SNET's petition, extending the scope of the cost-of-service affiliate transaction rules to cable systems regulated under the benchmark ratesetting approach would necessitate much more than the superficial "amendment" to the affiliate transactions rule proposed by SNET. Rather than asking the Commission to "reconsider" its decision, SNET is in effect asking the Commission to eliminate altogether -- or revamp substantially -- the benchmark ratesetting approach. Not only is there no adequate record regarding the fundamental policy change that SNET now seeks, there is in fact no legitimate basis to adopt uniform regulations, as the circumstances of the LECs on the one hand, and benchmark cable operators on the other, are wholly different.

More importantly, the Commission should reject SNET's argument that it should harmonize the cable and LEC cost allocation and affiliate transaction rules in light of the fact

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[2]Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992, MM Docket No. 93-215, Notice of Proposed Rulemaking, ("Cost-of-Service Notice"), FCC 93-353, 74 RR 2d 1247 (rel. July 16, 1993).

that "LECs and cable operators will enter each other's core market...within the next few months...."[3] Given the absence of genuine facilities-based competition in the local exchange, there is presently no valid public policy justification for harmonizing cable and LEC regulation. Although we agree with SNET that regulatory parity may be a desirable objective in the long term when robust competition exists in all telecommunications markets, regulatory parity is appropriate only where there is genuine competitive parity among market participants. Such competitive parity does not now exist. Instead, given the LECs' vast facilities, near total market share and control of the local exchange network, new entrants into the local exchange market, such as cable companies, will face a playing field that is stacked against them and in favor of incumbent LECs. The fact that the Commission is now in the process of implementing the 1996 Telecommunications Act[4] by developing rules aimed at preventing LECs from exploiting their significant market power to impede new market entrants, including cable companies, demonstrates the competitive disparity between these two classes of entities. In light of the competitive and regulatory differences between cable companies and LECs, the Commission should refrain from any consideration of so-called harmonization of cable and LEC regulation until such time that LECs face genuine facilities-based competition and the local exchange playing field is levelled.

SNET's request also mischaracterizes the cable benchmark ratesetting methodology and misses the point of the Commission's affiliate transaction rules. The Commission's

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[3]SNET Petition at 2.

[4]See Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 ("1996 Telecom Act").

application of affiliate transaction limitations only to LECs and cost-of-service regulated cable operators is valid in light of the differences in applicable regulation. Cable benchmark rates, despite their characterization by SNET as "price caps," are fundamentally different from rates established under the LEC price caps framework.[5] Unlike the cable cost-of-service and LEC price cap and rate-of-return ratesetting methodologies, which are either generally cost-based or derived in part from cost-based data, the cable benchmark ratesetting approach does not determine maximum permitted rates on the basis of an operator's costs. In fact, although the Commission intended the LEC price cap approach to eliminate the consideration of costs in ratesetting, in practice the price cap framework has not completely decoupled costs from the establishment of maximum permitted rates. Instead, price cap-regulated LECs still have the incentive to shift costs to affiliates in order to overstate their maximum permitted rates. The affiliate transaction rules in both the LEC and cable cost-of-service contexts are intended to prohibit regulated entities from charging unregulated affiliates artificially high rates in order to generate higher costs and, in turn, higher maximum permitted rates. In the case of cable benchmark regulation, however, such rules would not serve a legitimate purpose, given that the maximum permitted rate is based principally on exogenous factors unrelated to the operator's actual costs and could not be easily manipulated by self-dealing with affiliates.

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[5]Policy and Rules Concerning Rates for Dominant Carriers, 5 FCC Rcd 6786 (1990) ("LEC Price Cap Order"); recon., 6 FCC Rcd 2637 (1991) ("LEC Price Cap Reconsideration Order"), aff'd sub nom National Rural Telephone Ass'n v. FCC, 988 F.2d 174 (D.C. Cir. 1993).

In sum, SNET's proposals do not belong in this proceeding, fail to justify the imposition of regulatory parity to the cable and LEC cost allocation rules, overlook the fact that LECs and cable operators are subject to wholly disparate levels of competition, and urge an improper amendment to the affiliate transaction rule. The Commission should reject SNET's Petition accordingly.

II. THIS IS NOT THE PROPER PROCEEDING FOR THE COMMISSION TO CONSIDER SNET'S PROPOSAL FOR REGULATORY PARITY BETWEEN CABLE TELEVISION COMPANIES AND LECs

SNET's request that the Commission apply its affiliate transaction rules[6] to all cable operators subject to rate regulation, regardless of the manner in which their rates are regulated, is misplaced in this proceeding. As expressed by the Commission in its Second Report and Order, the purpose of this proceeding is limited to "adopt[ing] final rules governing standard cost of service showings filed by cable operators seeking to justify rates for regulated service."[7] Consequently, the scope of this proceeding does not encompass the issue of regulatory parity among LECs and cable operators regulated under the cost-of-service and benchmark ratesetting methodologies.

This proceeding was conceived in a Notice of Proposed Rulemaking released in conjunction with the Commission's 1993 Rate Order in which the Commission adopted the benchmark ratesetting methodology, recognizing that a cost-based ratesetting approach may

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[6]See 47 C.F.R. §§ 32.27(d)(LEC affiliate transaction rule); 47 C.F.R. § 76.924(i)(4) and (5)(cable cost-of-service affiliate transaction rule).

[7]Second Report and Order, 11 FCC Rcd at 2222.

more adequately compensate cable operators facing unusually high costs.[8] In the Cost-of-Service Notice, the Commission proposed to implement restrictions on the affiliate transactions of cost-of-service regulated cable systems in order "to prevent cable systems, in cost-of-service showings, from imposing the costs of nonregulated activities on regulated cable subscribers through improper cross-subsidization."[9] In addition, the Commission proposed to apply the affiliate transaction restrictions in the benchmark cap ratesetting methodology only as an optional mechanism for these cable operators to adjust their rates to reflect transactions with programming affiliates.[10] The Commission adopted these proposals

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[8]See Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992, Rate Regulation, Notice of Proposed Rulemaking, Report and Order and Further Notice of Proposed Rulemaking, 8 FCC Rcd 5631 (1993) ("1993 Rate Order").

[9]Cost-of-Service Notice, 74 RR 2d at 1260, ¶ 67.

[10]Id. In the 1993 Rate Order, the Commission permitted increases in these benchmark rates based on increases in programming costs, but limited pass-through of costs incurred with respect to affiliated programmers to no more than inflation. 1993 Rate Order, 8 FCC Rcd at 5787-88, ¶ 251. The Commission's Cost-of-Service Notice proposed to adopt the affiliate transaction requirement as an alternative to the inflation limitation imposed upon the affiliated programming costs of these cable operators. 74 RR 2d at 1260, n.68. In its First Reconsideration Order, however, the Commission reversed its decision to limit the pass-through of affiliated programming costs to inflation, and decided instead to allow cable operators to recover otherwise fair increases in the costs of programming exceeding inflation (reflecting either "prevailing company prices offered in the marketplace to third parties...or the fair market value of the programming." In the Matter of Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992: Rate Regulation; First Order on Reconsideration, Second Report and Order and Third Notice of Proposed Rulemaking; 9 FCC Rcd 1164, 1227-28, ¶ 14 (rel. Aug. 27, 1993).

on an interim basis in its 1994 Cost Order and Further Notice,[11] and finalized the rules in the Second Report and Order.

Notwithstanding the limited scope of this proceeding, SNET insists that the Commission should now expand the cable cost-of-service affiliate transaction rule to cover benchmark regulated cable operators, and cites as support the Commission's 1994 Cost Order and Further Notice.[12] There, the Commission inquired "whether it should conform its cable affiliate transaction rules to the rules applicable to LECs."[13] SNET's argument, however, mischaracterizes the Commission's inquiry in that item.

The 1994 Cost Order and Further Notice never sought comment on whether the Commission should apply the LEC affiliate transaction rules to both cost-of-service and benchmark regulated cable operators or otherwise implement regulatory parity with respect to affiliate transactions. Instead, the Commission merely proposed to conform the existing cable cost-of-service cost allocation and affiliate transaction requirements to recent changes to the LEC affiliate transaction rules.[14] Thus, the Commission did not seek to expand the application of the affiliate transaction rule to encompass all rate-regulated cable operators so

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[11]Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992: Rate Regulation and Adoption of a Uniform Accounting System for Provision of Regulated Cable Service, Report and Order and Further Notice of Proposed Rulemaking, 9 FCC Rcd 4527, 4664-65, ¶¶ 262-63 (rel. March 30, 1994)("Cost Order and Further Notice").

[12]SNET Petition at 5, n.5.

[13]Id. at 5.

[14]Cost Order and Further Notice, 9 FCC Rcd at 4684, ¶ 310 ("We tentatively conclude that the general changes we have proposed for telephone companies should be applied to cable operators as well.")

as to promote "harmonization." Instead it was considering only whether to modify the cable cost-of-service affiliate transaction rules to reflect technical changes in the corresponding affiliate transaction rule applied to LECs.[15] Hence, contrary to SNET's mischaracterization, the Commission did not contemplate the issue of regulatory parity among LEC and all rate-regulated cable systems in the 1994 Cost Order and Further Notice.

In addition, despite SNET's assertions to the contrary, the record in this proceeding does not provide an adequate basis to extend the scope of the affiliate transaction requirements to cable systems whose rates are regulated under the benchmark approach. To the contrary, given the fundamental differences between cable benchmark and cost-of-service regulation, the application of affiliate transaction requirements to all cable operators and LECs would necessitate much more than the cursory Commission "amendment" sought by SNET.[16]

To achieve the requested regulatory parity for the affiliate transaction rules, the Commission would need to conform the varying ratesetting methodologies in the cable and LEC contexts from the bottom up, uniformly applying a cost-based ratesetting approach to all regulated entities in order to justify the application of similar affiliate transaction limitations to all cable operators and LECs. Such an endeavor is far beyond the scope, purpose and

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[15]See, id. at ¶¶ 309-10 (proposing to conform the cable cost-of-service affiliate transaction rule to recent changes to the LEC affiliate transaction rule, including "limit[ing] the application of the prevailing company price as a measure of a reasonable price for an affiliate transaction," and "not permit prevailing company pricing as a valuation method for transactions between cable operators and their affiliates when a primary purpose of the non-cable affiliate in transactions is to serve the cable operator and its affiliates.")

[16]SNET Petition at 3.

record of this proceeding. In fact, it is just as misplaced as SNET's proposal to "conform the rules by amending the LEC rule to eliminate price regulation of the LEC's provision of network capacity to its cable TV affiliate" -- a proposal that even SNET concedes is "beyond the scope of the present proceedings since these proceedings involve amendments to regulations applicable to cable operators."[17] Significantly, the Commission has just commenced a proceeding that re-examines rules regarding cost allocation and notes that it may need to reform its Part 64 rules that are intended to deter unreasonable cost shifting both from cost misallocations of joint and common costs and from affiliate transactions.[18] Despite a broad consideration of those rules, the Commission did not propose to adopt the "parity" SNET seeks here. Clearly, the Commission understands the magnitude of such a rule change and has deliberately decided not to propose this amendment at this juncture.

In short, interposing SNET's proposal in this proceeding, at this late stage, couched as a Petition for Reconsideration would be inconsistent with the purpose and scope of this proceeding, would deny interested parties an opportunity to comment on SNET's proposal, would deprive the Commission of an adequately developed record on this issue, and would unnecessarily stall finalization of the Second Report and Order.

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[17]SNET Petition at 5, n.8.

[18]In the Matter of Allocation of Costs Associated with Local Exchange Carrier Provision of Video Programming Services, CC Docket No. 96-112, rel. May 10, 1996, at ¶ 9.

III. GIVEN THE ABSENCE OF GENUINE FACILITIES-BASED COMPETITION IN THE LOCAL EXCHANGE, THERE IS PRESENTLY NO VALID PUBLIC POLICY JUSTIFICATION FOR HARMONIZING THE CABLE AND LEC COST ALLOCATION AND AFFILIATE TRANSACTION RULES

The Commission should reject SNET's argument that the affiliate transaction rules should be applied equally among all rate-regulated cable companies and LECs in light of the fact that "LECs and cable operators will enter each other's core market...within the next few months via networks specially designed to provide both telephony and cable service."[19] Whether LECs and cable operators will be using similar hybrid equipment to enter each other's markets is irrelevant. What is relevant is that in light of the disparate regulatory and competitive landscapes facing cable companies and LECs, there simply is no valid public policy justification for harmonizing the cable and LEC cost allocation and affiliate transaction rules at this time.

Although regulatory parity is a desirable objective, it is appropriate only where there is genuine competitive parity among market participants. At present, such competitive parity does not exist between LECs and cable operators. Cable operators entering the local telephony marketplace are not presently active facilities-based competitors to LECs. In fact, today there is almost no genuine facilities-based competition in local telecommunications markets. Moreover, as the Commission well knows,[20] there are no rules in place that enable new entrants in telecommunications to compete with LECs on a level competitive playing

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[19]SNET Petition at 2.

[20]See In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, Local Competition Notice, FCC 96-182, ¶¶ 1-3 (rel. April 19, 1996)(recognizing the need for the Commission to establish rules governing the entry of competitors into the local exchange marketplace).

field. Instead, the local exchange playing field is tilted significantly in favor of the LECs by virtue of their being the only true facilities-based competitors at the local exchange level. Although the Telecommunications Act of 1996 removed many of the statutory barriers for cable operators and other competitors to enter the local telephony marketplace, there was a clear Congressional understanding that removal of these legal barriers in itself is not enough to enable competition to replace monopoly in the local exchange. LECs remain virtually unchallenged as entrenched dominant facilities-based monopolists.

Both Congress and the Commission have acknowledged that despite the elimination of statutory barriers to local exchange competition, cable and other companies entering the local exchange marketplace will face a playing field that is stacked against them, given the LECs' ubiquitous facilities, near total market share, economies of scale, and control of the local exchange network.[21] The Commission recognizes that the expansive network facilities of LECs enable them to serve new customers at much lower cost than could a new market entrant, such as a cable company or wireless system.[22] Congress itself acknowledged that "it is unlikely that competitors will have a fully redundant network in place when they initially offer local service, because the investment necessary is so significant."[23] Hence, new market entrants will be at the mercy of incumbent LECs for the transmission of traffic and other services. As the Commission noted in the Local Competition Notice, cable operators, like Cablevision, "will require substantial investment before either is capable of

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[21]Local Competition Notice at ¶ 6.

[22]Id.

[23]S. Conf. Rep. No. 104-230, 104th Cong., 2d Sess. 1 (1996) at 148 ("Joint Explanatory Statement").

providing a widespread substitute for wireline telephony services."[24] Given the LECs' operating efficiencies and resulting market dominance, it is no wonder that they possess at least an approximate 99.7 percent share of the local exchange market as measured by revenues.[25]

Not only are the LECs able to optimize their market share by relying upon the efficiencies produced by their ubiquitous networks, they also have the opportunity to exploit their facilities in order to impede competitors. In fact, Congress acknowledged the tremendous market power of local exchange carriers in enacting the 1996 Telecom Act, and directed the Commission to promulgate rules to prevent LECs from exploiting this monopoly power against new market entrants.[26] Toward that end, the Commission is presently engaged in the formulation of a number of rules governing the treatment of new local exchange market entrants by LECs. For example, in its Local Competition Notice alone, the Commission has invited comment on a number of proposed requirements on LECs, including requiring them to negotiate in good faith,[27] provide to competitors fair and nondiscriminatory interconnection with the network at "technically feasible points" and for

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[24]Local Competition Notice at ¶ 7 ("Virtually all cable systems...will require significant network upgrades in order to provide telephony service, including additional deployment of fiber optic cable, additional electronics, and backup power systems." Id., at n.16).

[25]Telecommunications Industry Review: TRS Fund Workshop Data, FCC Industry Analysis Division, Feb. 1996; as cited in Local Competition Notice at ¶ 6, n.13.

[26]See 141 Cong. Rec. S7984 (daily ed., June 7, 1995)(statement of Sen. Hollings)("Competition is the best regulator of the marketplace. But until competition exists, until the markets are opened, monopoly-provided services must not be able to exploit the monopoly power to the consumers' disadvantage."); see also Local Competition Notice at ¶¶ 6-7.

[27]Local Competition Notice at ¶¶ 46-48.

"just, reasonable and nondiscriminatory rates,"[28] unbundle and provide network service elements at fair and nondiscriminatory prices,[29] not prohibit nor impose unreasonable conditions upon the resale of telecommunications services,[30] provide reasonable number portability,[31] and provide dialing parity to local exchange competitors.[32] The comprehensiveness of these proposed rules safeguarding against the LECs' exploitation of their market power against new market entrants is particularly indicative of the disparity between the market power of LECs, which Congress and the Commission are attempting to bridle, and that of new entrants, like cable operators.

In light of these significant differences between the competitive postures of LECs and cable operators, the Commission's imposition of regulatory parity in the manner proposed by SNET in its Petition would be dangerously premature. Because cable operators and most other new entrants into the local exchange market are not yet genuine facilities-based competitors to incumbent LECs, these LECs possess significant competitive advantages over new market entrants. Consideration of regulatory parity among cable systems and LECs should happen only after the local exchange playing field is levelled and there is evidence of significant market penetration, with LECs facing true facilities-based competition and offering, to the Commission's satisfaction, the fair and reasonable interconnection,

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[28] Id. at ¶ 49 et seq.

collocation, number portability, resale and the other requirements for fair local exchange competition by the Commission.

IV. SNET HAS FAILED TO OFFER ANY VALID REASON FOR THE COMMISSION TO RECONSIDER ITS APPLICATION OF THE AFFILIATE TRANSACTION LIMITATIONS ONLY TO LECs AND CABLE OPERATORS REGULATED UNDER THE COST-OF-SERVICE RATEMAKING APPROACH

SNET is also incorrect in claiming that the application of affiliate transaction requirements to LECs under both rate-of-return and price cap regulation but only to cable operators under cost-of-service regulation violates the D.C. Circuit's admonition that the Commission "treat[] similarly situated parties alike or provid[e] an adequate justification for disparate treatment."[33] In arguing that affiliate transaction rules should apply to "price capped" rate regulated companies in both cable and LEC contexts, SNET improperly equates LEC price cap ratesetting with cable benchmark ratesetting, methodologies that are fundamentally different. Price cap regulated LECs and benchmark regulated cable operators are not "similarly situated parties." Moreover, the fact that the Commission applies affiliate transaction limitations only to LECs and cost-of-service regulated cable operators is justified, given that affiliate transaction limitations are useful only when applied to entities -- like LECs and cable cost-of-service operators -- whose maximum permitted rates could be artificially increased by self-dealing with affiliates.

The Commission's affiliate transaction rules in the LEC rate-of-return and price cap and cable cost-of-service contexts are intended to prohibit regulated entities from illegitimately inflating their costs by charging unregulated affiliates excessively high rates for

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[33]SNET Petition at 6, quoting McElroy Electronics Corp. v. FCC, 990 F.2d 1351, 1365 (D.C. Cir. 1993).

the transmission of traffic in order to generate higher permitted rates.[34] In its Order adopting cost allocation standards for LECs, the Commission noted that its "goal in establishing standards for transactions between affiliates is to prevent cost shifting to ratepayers by means of improper transfer pricing."[35] The Commission quoted the comments of the Department of Justice:

> If a firm produces nonregulated inputs needed to produce its regulated products, it has an incentive to cross-subsidize by selling itself those inputs at prices higher than the cost of producing them. This would increase the "cost" of the regulated product, but it would also increase the firm's total revenues because, under cost-based regulation, the regulators would permit a corresponding increase in the price of the regulated product.[36]

The Commission's stated rationale for the affiliate transaction rule in the cable cost-of-service context is based generally on its rationale for the LEC affiliate transaction limitations.[37]

In light of the purpose of the affiliate transaction rule -- i.e., preventing regulated entities from inflating their costs by charging unregulated affiliates excessively high rates in order to generate higher permitted rates -- it is only logical that the Commission should apply the rule to entities whose rates are regulated according to ratesetting methodologies that set maximum permitted rates in whole or in part on the basis of the entity's costs. That is precisely what the Commission has done.

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[34]See In the Matter of Separation of Regulated Telephone Service from Costs of Nonregulated Activities; Amendment of Part 31, the Uniform System of Accounts for Class A and Class B Telephone Companies to Provide for Unregulated Activities and to Provide for Transactions Between Telephone Companies and their Affiliates, Report and Order, 2 FCC Rcd 1298, 1334-35 (rel. Feb. 6, 1987).

[35]Id.

[36]Id. at 1335.

[37]Cost-of-Service Notice, 74 RR 2d at 1260, ¶ 67.

The cable cost-of-service ratesetting methodology is entirely cost-based, and serves as a 'backstop' method of rate regulation to meet the needs of cable operators with unusually high costs."[38] Under this approach a cable operator determines its allowable ratebase (including tangible plant in service, accumulated start-up losses, customer lists and franchise rights, operating expenses (including depreciation), and taxes) and adds an 11.25% rate-of-return.[39] The cable cost-of-service approach was patterned after the LEC rate-of-return ratesetting methodology, which also applies a "cost-plus" approach.[40]

The Commission adopted the LEC price cap ratesetting approach to encourage carriers "to produce greater benefits for both ratepayers and carriers than they would have received under the prior system of [rate-of-return] regulation."[41] Although the Commission intended that LEC price cap ratesetting would be divorced from the regulated carrier's costs,[42] in practice the Commission's price cap framework has not decoupled prices from costs.[43] In fact, the Commission has tentatively adopted price cap indexation formulas that are based explicitly on estimates of how the unit costs of the various telephone services

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[38]Cost Order and Further Notice, 9 FCC Rcd at 4534, ¶ 10.

[39]Id. at 4545, ¶ 37 et seq.

[40]Id. at 4539, ¶ 24.

[41]Policy and Rules Concerning Rates for Dominant Carriers, 6 FCC Rcd 2637, 2640 ¶ 3 (1991) (Price Cap Reconsideration Order); see also 5 FCC Rcd 6786 (1990) ("LEC Price Cap Order").

[42]See Price Cap Reconsideration Order, 6 FCC Rcd at 2640; see also J. Thorne, P. Huber, M. Kellogg, Federal Broadband Law, 411 (1995)("Under pure price-cap regulation, it does not matter where costs are allocated; the price of regulated service is set without reference to costs").

[43]See Thorne, et al., at 411.

considered in determining the price cap behave relative to general inflation.[44] Thus, price cap-regulated LECs may have the incentive to shift costs into the indexation formula in order to overstate their maximum permitted rate.

Under both the cable cost-of-service and LEC rate cap ratesetting methodologies, therefore, a regulated entity can artificially raise the maximum permitted rate by manipulating its costs. In contrast, the cable benchmark methodology does not consider at all the operator's costs in determining the maximum permitted rate. Under the benchmark rules, the Commission required cable operators to reduce their regulated rates to a level that represented their September 30, 1992 regulated revenues reduced by a 17% "competitive differential" (adjusted for annual inflation increases, changes in external costs and changes in the number of programming channels).[45] The 17% "competitive differential" represented the average difference that the Commission determined existed between the rates of competitive and noncompetitive systems.[46] Unlike LEC price caps, the price cap mechanism in cable's benchmark ratesetting approach governs only the manner in which operators can adjust their rates on a going forward basis following the establishment of initial maximum

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[44]Price Cap Performance Review for Local Exchange Carriers, Fourth Further Notice of Proposed Rulemaking, CC Docket No. 94-1, ¶¶ 13, 22-40 (rel. Sept, 27, 1995).

[45]In the Matter of Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992: Rate Regulation, Second Order on Reconsideration, Fourth Report and Order, and Fifth Notice of Proposed Rulemaking, 9 FCC Rcd 4119, 4124 (1994) ("Second Reconsideration Order").

[46]Id.

permitted rates.[47] Under the cable approach, operators adjust their rates annually for inflation and may reflect changes in external costs and changes in number of regulated channels up to four times per year.[48]

In sum, given the purpose of the affiliate transaction rule, the Commission is correct in applying the rule to cable cost-of-service operators and both rate-of-return and price cap regulated LECs, but not to benchmark regulated cable operators, whose rates are not cost-based. The Commission should reject SNET's argument to the contrary.

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[47]Id. at ¶ 239, et seq. Cable operators now have an optional price cap adjustment mechanism whereby operators can adjust their rates once per year to reflect reasonably certain and reasonably quantifiable changes in external costs, inflation, and the number of regulated channels that are projected for the 12 months following the rate change. See In the Matter of Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992: Rate Regulation, Thirteenth Order on Reconsideration; FCC 95-397; MM Docket No. 92-266, 78 RR 2d 1688 (rel. Sept, 22, 1995) at ¶ 7.

[48]Id.

V. CONCLUSION

For the reasons above, the Commission should dismiss the Petition for Partial Reconsideration of the Second Report and Order filed by Southern New England Telephone Company on February 26, 1996.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I, Paula Allen, do hereby certify that on this 16th day of May, 1996, a copy of the foregoing Opposition of Cablevision Systems Corporation to The Petition For Partial Reconsideration of The Southern New England Telephone Company was sent via U.S. first class mail, postage prepaid, or delivered by messenger (*) to the following:

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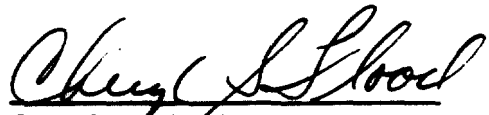

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